The banks: giving us what we deserve

Contrary to popular wisdom, Australia's banks are not secretive hoarders of information, keeping their shareholders in the dark. These days, writes ***Patrick Burroughs****, their record of disclosure is better than ever.*

Bank bashing appears to have become a national pastime, with both the industry and certain players continuing to be the subject of considerable scrutiny. Aside from the Martin inquiry, there is (or has been) the Tricontinental royal commission, the State Bank of South Australia royal commission and the continuing fascination of the media with the results and bad debts of the major banks. It is tempting to ask what all this is going to achieve and whether the future will be better than the past.

A study of the past, properly known as history, was once a subject taught with great application and respect in Australian schools. The only problem, some would have said, is that the history studied was that of Europe and, in particular, the British empire rather than Australia.

That's as may be. There has, nonetheless, been much focusing during this recession on prior recessions and banking collapses, even going back to the 1890s and the era of the Landboomers.

The fact is that in good times, people forget about history—in particular, the lessons of history—and believe they are blessed with the wisdom of Solomon. In bad times they wish they did in fact have the wisdom of Solomon and the historical perspective, often referred to as hindsight by lawyers and other litigants, comes to haunt the high-fliers who, like Icarus, flew too close to the sun.

Well, the time for bank bashing is over and if Australia wishes to proceed down the road of economic growth, rising standards of living and better employment prospects, then its politicians and community leaders need to recognise that a strong, profitable and well capitalised banking industry is a fundamental part of the economic fabric of our society.

However, only a fool would ignore the fact that the banks have a credibility problem in the community and have a major task ahead of them to repair the damage to both their reputations and their balance sheets. They are not alone, however.

Returning to history temporarily, it tends to tell us that openness and frankness in dealing with one's problems, usually known simply as telling the truth, is the first step in winning back support from constituents. Some banks seem to have adopted this approach, judging by the utterances in recent times by some of their senior executives.

What this article seeks to demonstrate is that the financial information now being provided by banks in their financial statements has indeed established a new level of openness and frankness–disclosure, in accounting jargon–and makes the accounts of banks at the time of the last major property collapse (1974-75) pale into insignificance.

At that time, the household names were Mainline, Cambridge Credit and Gollin. There were also big difficulties with a major nickel project in Queensland known as Greenvale and inflation was starting to become the endemic disease that the current recession has cauterised.

The banks in Australia existed in a regulated industry and one could argue that the only area of real management decision-making and influence was controlling overheads. Net interest margin was effectively determined by the regulators, as were, largely, fees and the like. Bad debts of course existed, as they always will (and should) in banking, but the regulated market focused very much on secured lending.

The great complaint by politicians and the business community was the unwillingness of banks to take a risk and lend on a "good project" without watertight security. That complaint is now resurfacing.

The financial statements of banks told absolutely nothing about their true financial condition. They were prepared in accordance with the practice of so called non-disclosure. This practice was based on the premise that to maintain depositor confidence in the financial system, this being fundamental to the survival ultimately of governments, the less the public knew about the real financial condition of its major banks, the less it would worry. The job was left to the Reserve Bank.

So a bank "lost" its contingencies reserve within its liabilities (included

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in the depositors' caption in the balance sheet). This hidden reserve enabled it to smooth profits in bad years and, for that matter, good years. Indeed, profit smoothing was an accepted practice and regarded as good practice. Any one-off, funny items such as a change in tax rates would go direct to contingencies reserve and not through the profit-and-loss account.

In a period of recession, such as 1974-75, if there was a need to boost the provision for doubtful debts one didn't do it by charging the profit-and-loss account. One did it by an allocation from contingencies reserve and eventually, at the end of the financial year, the major decision to be made by the board and, in particular, the chief executive and the auditors, was the trend-line of profitability. If that needed a bit of a boost or adjustment via the contingencies reserve, then so be it.

So profit, as disclosed in the published financial statements, was not the real profit at all, but rather profit *after* transfers from contingencies reserve and *after* provisions for doubtful debts. This was known as published profit, with the result that shareholders, analysts and the community at large were not informed about the charge against profits for doubtful debts and they were certainly not informed about the level of unproductive lending.

The Chanticleers and analysts of this world, let alone the poor old shareholder or depositor, really knew nothing at all about the real financial condition of banks. This, then, is the first major asset recession–or, for that matter, major recession of any sort–where the financial condition of the banks has been spelt out so clearly.

TABLE 1: Disclosure by major banks (based on accounts of ANZ, NAB and Westpac)

(D = disclosed, ND = not disclosed, PD = partially disclosed, N/A = not applicable) *(based on 1991 accounts) **(based on 1975 accounts) ***(based on 1983 accounts)

	1991-92 recession*	1974-75 recession**	1982-83 recession***
Charge to profits for bad and doubtful debts	D	ND	D
Provisions for doubtful debts and the movement therein analysed between specific and general	D	ND	PD
Unproductive, past due and restructured loans	D	ND	ND
Real shareholders' funds (capital adequacy)	D	ND	D
Detailed calculation of capital adequacy	D	N/A	N/A
Industry spread and concentration of credit risk	D	ND	ND
Cross-border credit risk and rescheduled debt exposures	D	ND (N/A for re-scheduled debt)	ND
Analysis of deposit base by type and between Australia and overseas	D	ND	ND
Analysis of interest income and interest expense in terms of volume and rate	D	ND	ND
Average interest-earning assets and interest-bearing liabilities over past three years	D	ND	ND
Analysis of interest spread and net interest average yield	D	ND	ND
Analysis of investment securities by maturities, yields, nature and domicile	D	ND	ND
Analysis of certificates of deposit by nature, term and domicile	D	ND	ND
Off-balance-sheet exposures	D	ND	ND

Note: *The three major banks (ANZ, NAB & Westpac) were not in the past totally consistent with each other as to the level of disclosure and for the purposes of this summary I have not sought to identify discrepancies. An example is the movement in the provision for doubtful debts, analysed between specific and general provisions. In the 1983 accounts this was only partially provided by NAB and Westpac, but fully provided by ANZ. It is interesting that following Westpac's changed treatment in the 1991 accounts of its general provision, the three majors were once again at variance in this key area.*

Regrettably, the majority of the above items compared in Table 1 are not required by Australian law to be disclosed, although they are obviously critical to the appreciation of the financial condition of a bank, in particular its *risk* profile. The major banks provide the information "voluntarily" because they need it for SEC listing purposes.

One might ask why the Reserve Bank has never taken a greater leadership role in the public financial reporting of banks (and industry generally, which, after all, borrows from the banks) and while the Martin Committee has recommended greater disclosure in banks' annual reports, it is unclear who has the responsibility to take this further. In the UK, the Bank of England is a major contributor to the funding base of the UK Financial Reporting Council and Accounting Standards Board and takes a keen interest in the quality of financial reporting, as does the Federal Reserve Board in the US.

We stand at present, therefore, with the major Australian banks providing a level of disclosure and information on the *risks* inherent in their business that is unprecedented in Australian reporting history. Indeed, the level of information is greater, I would argue, than that disclosed by other Australian companies taken as an industry group, and has partly enabled the market to better price banks' stocks. The classic in this

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